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May 23, 2002

Via Hand-Delivery

K. David Waddell
Executive Secretary
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, Tennessee 37219

**Re: Petition of Chattanooga Gas Company for Approval of Change
in Purchase Gas Adjustment
Docket No. 02-00383**

Dear Mr. Waddell:

Enclosed you will find the original and 13 copies of Chattanooga Gas Company's pre-filed rebuttal testimony in the above referenced docket.

Sincerely,



D. Billye Sanders
Attorney for Chattanooga Gas Company

DBS:lmb
Enclosures

cc: Hal Novak
Archie Hickerson
Earl Burton
Vance Broemel

CERTIFICATE OF SERVICE

I hereby certify that on this 23rd day of May, 2002, a true and correct copy of the foregoing Rebuttal Testimony was served on the persons below by hand delivery or by placing same in the U.S. mail, postage pre-paid:

Consumer Advocate and Protection Division
Office of Attorney General
2nd Floor
425 5th Avenue North
Nashville, Tennessee 37243-0491

Mailing address:

P.O. Box 20207
Nashville, Tennessee 37202

D. Billye Sanders
D. Billye Sanders

1 **Q. Please state your name and give your business address.**

2 A. My name is William H. Novak, and my business address is 1219 Caroline Street, Atlanta,
3 Georgia 30307. My qualifications and work experience are contained in my direct
4 testimony that was previously filed.

5 **Q. Have you reviewed the direct testimony filed May 21, 2002 by the Consumer**
6 **Advocate and Protection Division ("CAPD") in the Office of the Attorney General?**

7 A. Yes. I have reviewed the direct testimony and exhibits of CAPD witnesses Robert T.
8 Buckner and Michael D. Chrysler.

9 **Q. Do you have any comments with respect to Mr. Buckner's testimony?**

10 A. Yes. While I believe both Mr. Buckner and I can agree on the basic facts of this docket,
11 we have reached vastly different conclusions regarding whether the Fixed Rate PGA will
12 be beneficial for the customers of Chattanooga Gas Company ("Chattanooga" or
13 "Company").

14 Beginning on page 3 of his direct testimony, Mr. Buckner correctly states that that the
15 Fixed Rate PGA includes "a risk premium and other pro forma risk protection as
16 additives to the commodity cost of gas charged to the consumers." On this same page,
17 Mr. Buckner again correctly points out that the Fixed Rate PGA "is not optional for
18 residential and commercial consumers." However, while we can both agree with these
19 two underlying facts of the Company's proposal, Mr. Buckner identifies these issues as
20 the primary reasons for his opposition to the proposed Fixed Rate PGA while I see them
21 as necessary requirements to insure that the Fixed Rate PGA will operate successfully.

22 **Q. Why is Mr. Bucker opposed to the risk premium component of the Fixed Rate PGA**
23 **and what is your response to his testimony regarding this?**

1 A. He states several reasons, and I will try to address each of his concerns. Starting on page
2 4 of his direct testimony, Mr. Buckner states that the risk premium component of the
3 Fixed Rate PGA "provides compensation to CGC which is not based on actual costs."
4 Again, while I agree with Mr. Buckner's assessment, I disagree with his conclusion.
5 Webster's New World Dictionary defines risk as "the chance of injury, damage or loss."
6 (Emphasis added). Therefore, by its very definition, risk does not involve an actual cost
7 or loss, but rather the chance of a cost or a loss occurring. Currently, the risk of increased
8 gas costs is borne entirely by our customers since the existing PGA rule allows these gas
9 costs to be automatically passed through to them in the form of higher gas rates. The
10 "compensation" that Mr. Buckner refers to in this statement is not designed to cover any
11 specific quantifiable costs but rather the risk or chance that these costs may occur.
12 In addition, Mr. Buckner states on page 4 of his direct testimony that the Company only
13 provided "two specific examples of risks, demand costs and Federal Energy Regulatory
14 Commission ("FERC") rates". He then goes on to conclude from this that "the actual
15 quantification of those risks is not provided and no other specific risks are identified."
16 Again, we agree on the facts, but disagree on the conclusions from those facts. While the
17 Company did only give two examples of risk in our direct testimony as pointed out by
18 Mr. Buckner, he fails to mention that we also provided four other specific examples of
19 risk in our response to Item 8 of the CAPD's May 13th data request. Each of these six
20 types of risk mentioned in our direct testimony and data request responses is in fact real
21 and has actually occurred to the Company at one degree or another in the past. However,
22 my direct testimony that is quoted by Mr. Buckner stating that this risk "is relatively low"
23 has been taken out of context and mischaracterized. What should have been stated was

1 that while the probability of these risks materializing is relatively low when compared
2 with the identified components in the Fixed Rate PGA formula, their effect can be
3 substantial. Because of this effect, it is very difficult to quantify the risk premium
4 component of the Fixed Rate PGA. However, just because these risks are difficult to
5 quantify does not mean that they do not exist as Mr. Buckner implies.

6 Finally, Mr. Buckner concludes his criticism of the risk premium component of the Fixed
7 Rate PGA by stating on page 4 of his testimony that Chattanooga's "...customers are
8 being asked to pay a risk premium for risks that either are unknown or cannot be
9 quantified or may not materialize at all". While this statement is true, it is also true of
10 almost any other type of risk. First, by its very nature the value of risk is rarely known
11 beforehand. If the risk value were known, then it likely wouldn't be characterized as a
12 risk at all but rather as a known cost. Secondly, risk can rarely be quantified, except
13 possibly on a backward looking after-the-fact basis. This is because as stated above risk
14 represents the chance that a loss or cost can occur and not the quantification of that cost.
15 Finally, it is true that this risk "may not materialize at all". However it is equally true that
16 the actual risk incurred could far exceed what was planned for and will result in a loss for
17 the Company. In either case, the gain or loss will be accounted for in the Company's
18 below the line operations.

19 **Q. Do you have any further comments with respect to Mr. Buckner's criticism of the**
20 **risk premium component of the Fixed Rate PGA?**

21 A. Yes. As shown on Rebuttal Exhibit WHN-1, we have significantly reduced the risk
22 premium component of the Fixed Rate PGA from \$0.12 per Ccf that was included in last
23 years' filing to approximately \$0.05 per Ccf that we have included in this docket.

1 Approximately \$0.04 per Ccf of this reduction took place in the form of financial collars
2 that were separately identified in the Fixed Rate PGA formula. However, we have also
3 voluntarily reduced the risk premium by \$0.03 per Ccf or 25% from what we included
4 last year. In addition, as shown on Rebuttal Exhibit WHN-2, the Fixed Rate PGA
5 calculation based on the Company's amended filing and the May 2002 scenario produces
6 a rate of \$0.6211 per therm. This rate is competitive at the low end with similar fixed
7 service offerings from the various marketers in Georgia's deregulated gas market.
8 Admittedly, this is not a completely direct comparison because the Company's proposed
9 rate of \$0.6211 per therm would be for a one-year period beginning October 1, 2002
10 while it is compared with the current fixed rates of marketers that began in May 2002. I
11 point this out only to show that the gas cost and the risk premium proposed by the
12 Company for the customers of Chattanooga are well within the existing range of similar
13 offers for Georgia customers.

14 **Q. Do you agree with Mr. Buckner's rate comparison of the Fixed Rate PGA and the**
15 **historical pga billing rates?**

16 A. No. What Mr. Buckner has done on page 5 of his testimony is to compare the Fixed Rate
17 PGA billing rate of \$0.6397 per Ccf that is based on the Company's amended filing
18 updated for the May 2002 scenario, with the historical pga billing rates for the past eleven
19 months. He then concludes that the Fixed Rate PGA proposal should be rejected because
20 the historic pga rate "exceeded the proposed FRT rate of \$.64 for only one month in the
21 period." However, this is an apples and oranges comparison. The Fixed Rate PGA
22 billing rate of \$0.6397 per Ccf represents the price for gas that will be sold on the futures
23 market beginning in October 2002. To compare this rate with the actual historic pga

1 billing rate from May, 2001 through March, 2002 is improper. This distortion is more
2 clearly shown on Rebuttal Exhibit WHN-3. As shown on this exhibit, the proposed Fixed
3 Rate PGA does exactly what it is designed to do; that is to take rate volatility out of the
4 rates for Chattanooga's customers.

5 **Q. On page 5 of his testimony, Mr. Buckner mentions that the proposed Fixed Rate**
6 **PGA provides no real incentive for the Company to obtain the lowest possible gas**
7 **commodity costs. Do you agree with this statement?**

8 A. No, I do not. As mentioned in Item 9 of our responses to the CAPD's data request of
9 May 13, natural gas is a fuel of choice for Chattanooga's customers. Because of this, it is
10 financially imperative that the Company avoid entering into any long-term contracts for
11 gas deliveries that would place our service at a competitive disadvantage with other fuels.
12 As such, the Company always has an incentive to purchase the "best price" gas available
13 for its customers since doing so secures our long-term viability as an economic
14 distributor of energy.

15 **Q. Mr. Buckner also mentions on page 5 of his testimony that the Company will not**
16 **take bids from any other suppliers for this type of service. Do you have any**
17 **comments in regards to this statement?**

18 A. Yes. We have structured the components of the Fixed Rate PGA so that their value can
19 be independently verified by the CAPD and the TRA Staff. The underlying variables of
20 these components are based on the future market rates for natural gas. Because of this,
21 the Company believes that there is very little that an outside supplier will be able to make
22 an effective bid with. Instead, the actual gas prices that will be obtained in the futures
23 contracts on October 1st will be placed into the Fixed Rate PGA formula. Again these

1 prices can be verified and are subject to the same prudence criteria that the Company is
2 currently held to, in spite of Mr. Buckner's statement to the contrary on page 6 of his
3 testimony.

4 **Q. Why does Mr. Buckner take issue with applying the Fixed Rate PGA to all**
5 **Residential and Commercial customers and what is your response to his testimony**
6 **regarding this?**

7 A. Based upon his testimony, I am unclear as to the exact cause of Mr. Buckner's issues
8 relative to the Company applying the Fixed Rate PGA to all of its Residential and
9 Commercial customers. As stated in our direct testimony, we did consider offering this
10 service as an option to our customers. Unfortunately, our examination revealed that the
11 cost of changing our computer billing system, educating customers and training
12 employees to manage those customers who chose a fixed rate and others that chose to
13 remain on a variable rate would be prohibitive.

14 I suppose that in a "perfect world" the Company would be able to offer the Fixed Rate
15 PGA to only those customers specifically desiring this type of service. However, there
16 are only approximately 60,000 Residential and Commercial customers of Chattanooga
17 Gas Company. This means that Chattanooga is much smaller than most of the firms
18 listed in Mr. Chrysler's Exhibit C-1 that offer an optional fixed rate which have as many
19 as two million customers. In addition, Chattanooga is less than half the size of the other
20 Class A gas utilities in Tennessee. This means that we have a much smaller base of
21 customers to recover the costs that are involved in making the Fixed Rate PGA an
22 optional service.

23 **Q. Do you have any concerns relating to Mr. Chrysler's testimony?**

1 A. Yes. On page 3 of his testimony, Mr. Chrysler refers to his Exhibit C-1 that I mentioned
2 earlier. On this Exhibit Mr. Chrysler identifies six utilities, two of which are affiliates of
3 the utility that he has had prior employment with, that offer an optional fixed rate service
4 to their customers. Mr. Chrysler then refers to this Exhibit in his testimony and
5 concludes that the Company's proposal "with its imposition of a fixed PGA on
6 customers, is an extreme position and is clearly counter to the general practice of giving
7 customers the option of choosing or rejecting a fixed rate PGA." As stated above, the
8 utilities identified by Mr. Chrysler are much larger than Chattanooga Gas Company and
9 have therefore have a larger base of customers upon which to recover their fixed costs.
10 To demonstrate this, I have expanded Mr. Chrysler's exhibit to show this disparity which
11 is reproduced below.

Utility	Jurisdiction	Customers
Chattanooga Gas Company	Tennessee	60,000
Northern Utilities	New Hampshire and Maine	46,000
Energy North	New Hampshire and Massachusetts	800,000
Equitable Gas	Pennsylvania and West Virginia	260,000
Baltimore Gas & Electric	Maryland	565,000
NIPSCO	Indiana	670,000
NICOR Gas	Illinois	2,000,000

12 In addition, Mr. Chrysler offers no testimony on the source of his Exhibit C-1 and does
13 not state if these were all the companies with optional fixed rate services that he
14 discovered or whether these were just the ones he chose to present. In spite of this
15 omission, he characterizes the results of the six utilities he identified as a "general
16 practice" while describing Chattanooga's proposal as "extreme".

17 Also on pages 3 and 4 of Mr. Chrysler's testimony, he refers to his Exhibit C-2 which is a
18 redistribution of Ms. Wright's survey responses into only two groups ("choosing" or "not

1 choosing") instead of the three groups ("for", "indifferent" or "against") that Ms. Wright
2 presented. However, while Mr. Chrysler correctly identified the same eleven survey
3 respondents that were in favor of the Fixed Rate PGA, he chose to classify all of the
4 respondent responses that Ms. Wright classified as indifferent into his "not choosing"
5 category. This misclassification was obviously done solely to give the wrong impression
6 to the TRA on the results of the survey. The correct classification and results of the
7 survey are shown on Rebuttal Exhibit WHN-4.

8 Finally, on page 3 of his testimony, Mr. Chrysler attacks the results of Ms. Wright's
9 study as "not representative of the customer base...and of limited value". Mr. Chrysler's
10 criticism seems to come from the small sample size chosen by Ms. Wright, which she
11 admits may not necessarily be representative of our entire customer body. As explained
12 in our data request responses, the reason for the small sample size was the considerable
13 time and cost that is necessary to first educate the customer about the current pga process
14 in order for these customers to make an informed decision regarding the proposed Fixed
15 Rate PGA. This education process can be witnessed firsthand through an examination of
16 the videotaped surveys conducted by Ms. Wright. Alternatively, Ms. Wright could have
17 performed either a telephone or an internet survey. While the responses to such a survey
18 would have been larger and arguably statistically valid, they would not have been as
19 valuable to the Company, since the education process that must be done face-to-face
20 would have been foregone.

21 **Q. Do you have any closing comments?**

22 A. Yes. Mr. Buckner describes in his testimony that the rates experienced in the winter
23 period of 2001 as a "recent aberration of the gas market." I am assuming by this

1 characterization that he means that we had the effect of colder than normal weather
2 coupled with higher than normal rates that produced bills that were much higher than
3 customers had come to expect. However, if Mr. Buckner means that this situation is not
4 likely to reoccur, then I have to strongly disagree.

5 What we are experiencing now are several changes in the natural gas environment that
6 are contributing to a new type of "aberration". One of the most significant of these
7 changes is the rapid acceleration of using natural gas to generate electricity. This has
8 produced new demands for natural gas, especially in the summer months, that have made
9 it much more difficult to forecast the traditional gas supplies available to place into
10 storage. In addition to this phenomenon, we have also recently experienced supply
11 disruptions from oil markets in Venezuela and the Middle East. Because natural gas can
12 often be used as an alternative for oil, its price and supply can be altered greatly by these
13 events. Finally, we are seeing unprecedented changes and shifts in the natural gas supply
14 markets from major marketers such as Enron, Dynegy, Reliant and others. All of these
15 factors are coming together and could create more frequent "aberrations" which may
16 result in significant volatile swings in natural gas prices.

17 In fact, these volatile swings in wholesale natural gas prices can be witnessed today as
18 shown on Rebuttal Exhibits WHN-5 and WHN-6. Rebuttal Exhibit WHN-5 is a graph
19 depicting the wholesale market price of natural gas over the last four to five years. From
20 this graph, you can visualize the "aberration" during the winter period of 2001 that Mr.
21 Buckner refers to, but you can also see the continued daily volatility that has been
22 experienced since this time in the wholesale natural gas market. The evidence of this
23 volatility in the wholesale gas market is even more evident on Rebuttal Exhibit WHN-6.

1 This Exhibit is a graphical depiction of the gas prices for the January 2003 futures market
2 from November 2001 through May 21, 2002. As can be seen from this graph, the price
3 for January 2003 deliveries in November 2001 started out at \$3.70 per Dkt, then dropped
4 to \$2.97 per Dkt in February of 2002, and has climbed back to \$4.23 per Dkt on May 21,
5 2002. Our Fixed Rate PGA proposal will remove some of this volatility. While I won't
6 say that our proposal is perfect by any means, we have offered it as an experimental tariff
7 that can be altered annually upon approval of the TRA.

8 **Q. Does this complete your testimony?**

9 **A.** Yes, it does.

Chattanooga Gas Company

RISK PREMIUM COMPARISON

Docket 01-00761 and Docket 02-00383

Risk Premium included in Docket 01-00761	<u>\$0.12</u>
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Less:

Financial Collars	0.04
Premium Reduction	0.03

Risk Premium included in Docket 02-00383	<u>\$0.05</u>
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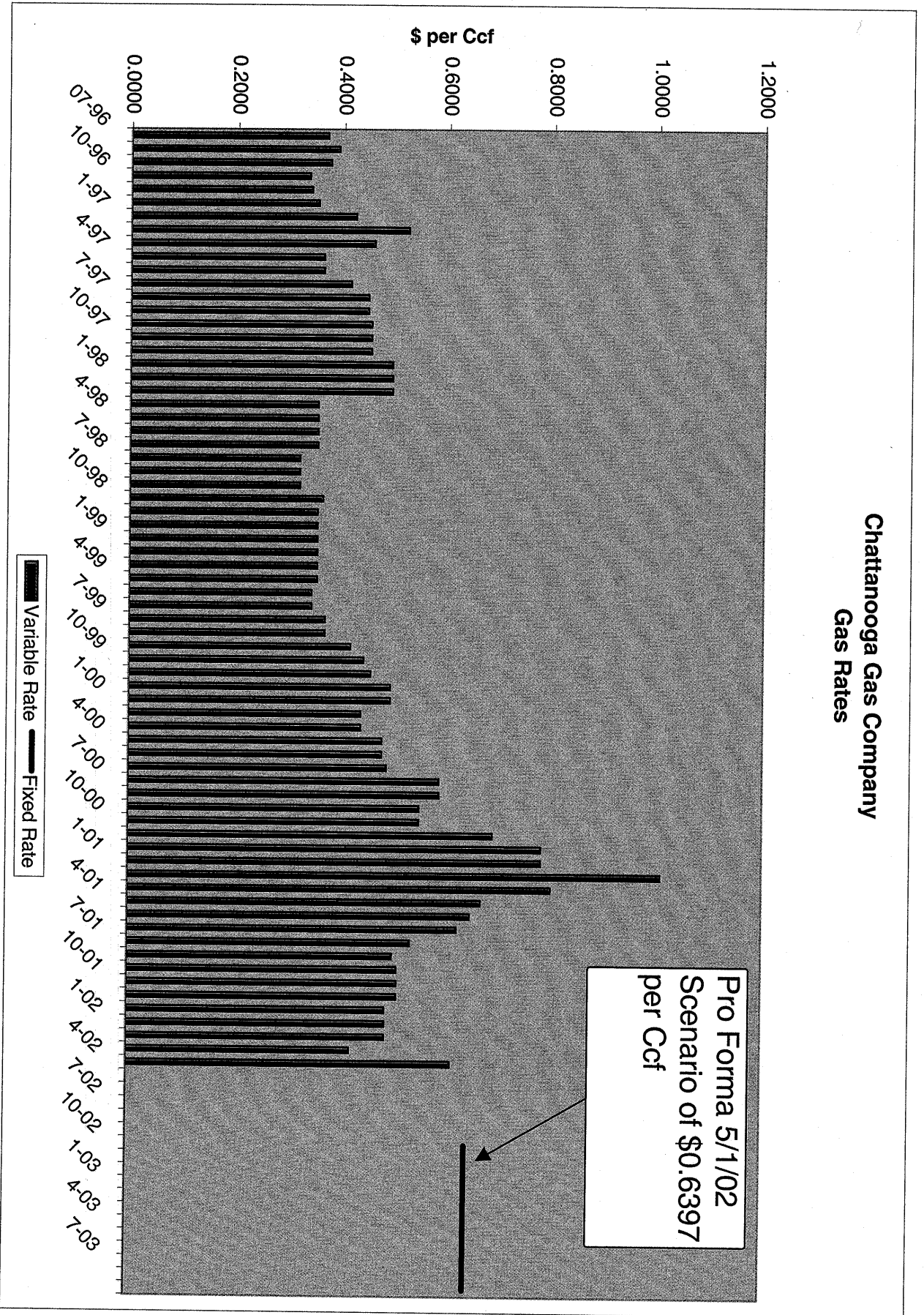
May 2002 Certified Gas Marketers Price List

Prices shown are through May 5, 2002. There are no guarantees that these prices are accurate for any date after 05/05/2002.

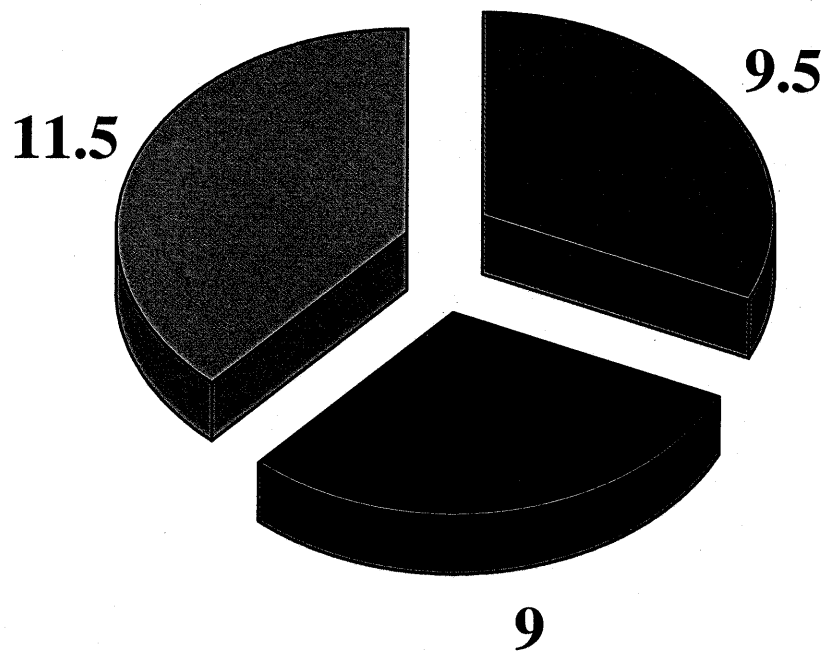
Certified Gas Marketer Commodity Price Interstate Capacity Customer
 (per therm) Charge Service Charge Other Charges

Chattanooga Gas Company					
Proposed Fixed Rate	\$0.6211	\$0.00	\$0.00		CGC Base Charge
Effective 10/1/02 (May Scenario)					
ACN Energy	\$0.5750	\$4.4300 per DDDC Factor	\$4.95		AGL Base Charge \$0.65 per DDDC--balancing \$0.00 per DDDC--imbalance charge
Energy America	\$0.6193	\$9.3718 per DDDC Factor	\$7.05		AGL Base Charge
Gas Key (Variable)	\$0.6070	\$3.9900 per DDDC Factor Variable	\$5.50		AGL Base Charge \$2.2437 per DDDC--Retained Storage
Gas Key (Senior Citizen/Low-Income)	\$0.4856				
Georgia Natural Gas (Fixed)	\$0.5990	Included in Commodity Charge			
Georgia Natural Gas (Variable)	\$0.6590				
Georgia Natural Gas (Senior Citizen/Low-Income)	\$0.5590		\$4.90		AGL Base Charge
Infinite (Fixed)	\$0.7690	Included in Commodity Charge	\$5.95		AGL Base Charge
Infinite (Variable)	\$0.7690				
New Power Company (Fixed)	\$0.6790	Included in Commodity Charge	\$4.75*		AGL Base Charge
New Power Company (Variable)	\$0.5990				
Scana (Fixed)	\$0.6990	Included in Commodity Charge	\$4.95*		AGL Base Charge
Scana (Variable)	\$0.6990				
Shell (Fixed)	\$0.6950	Included in Commodity Charge	\$5.95		AGL Base Charge
Shell (Variable)	\$0.6750				
Prices shown are for May 5, 2002. There are no guarantees that these prices are accurate for any date after May 5, 2002.					
Prices do not include the base charge from Atlanta Gas Light Company. This charge is \$10.39 + (\$4.55 per DDDC Factor) or \$(-0.44) + (\$4.55 per					
The Base Charge is the same regardless of which marketer is chosen.					
Customer specific DDDC Factors can be obtained by calling the selected marketer.					
Prices DO NOT include sales tax, which varies by county.					

Chattanooga Gas Company Gas Rates



Opinions of Annual Fixed Rate PGA



■ Against ■ Indifferent ■ Favor



